

The Final Accounts: Income Statement and Statement of Financial Position

The Final Accounts:

Income Statement and Statement of Financial Position

The **Income Statement** was previously known as and called the **Trading & Profit + Loss Account**. Looking at the name '**Trading and Profit & Loss Account**' it can be interpreted to contain two aspects being:-

1. **Trading Account,**
2. **Profit and Loss Account (P&L a/c).**

The **Trading Account** is, simply put, a 'format' which attempts to show as clearly as possible the business' **Gross profit or Gross Loss** for a specific **Accounting Period**. A typical period is 12 months.

The Trading Account shows the **Gross Profit/Loss** through a formula:

Net Sales - Cost of Sales = Gross Profit/Loss.

The following are formulae used to calculate balances in the Income Statement.

1. **Net Sales = Sales - Returns Inwards (Sales Returns)**
2. **Net Purchases = Purchases + Carriage Inwards - Returns Outwards (Purchases Returns)**
3. **Cost of Sales = Opening Stock + Net Purchases - Closing Stock**
4. **Cost of Goods Available for Sales = Opening Stock + Purchases – Returns Outwards + Carriage Inwards**

The Cost of Sales representing the **direct cost** incurred to generate a sale e.g. Costs of Sales to Francis Fashions are the clothes it buys for resale.

The ***Profit and Loss a/c*** is, simply put, a 'format' which attempts to show as clearly as possible the business' **Net Profit or Net Loss** for a specific **Accounting Period**. The P&L a/c shows the **Net Profit/Loss** through a formula: **Gross Profit/Loss — Total Expenses = Net Profit/Loss**.

In this case, 'total expenses' comprises of all other expenses which are not directly incurred to generate a sale e.g. Francis Fashions rents a shopping space in West Mall to retail its merchandise, the cost of Rent is an indirect cost. Rent has nothing to do with the actual clothing and an accessory sold by the business, but is needed as part of running the business so that customers can come to a convenient location to buy their merchandise. This type of indirect expense is also called '**OVERHEADS**'.

The Statement of Financial Position was previously known as and called the **Balance Sheet**. The name '**Balance Sheet**' can be interpreted as a schedule or sheet which attempts to **balance** something. That 'something' is the Accounting Equation!

The Balance Sheet shown is in a horizontal format (from left to right) in a similar structure to a T-Account where assets are listed and totaled on the 'left side' and liabilities and capital are listed and totaled on the 'right side'. When done correctly the Accounting Equation would have been demonstrated by both sides totaling each other.

On the contrary, the Balance Sheet has now evolved and typically is presented through the vertical format (top to bottom) along with a name change known today as The Statement of Financial position. Now let's enforce what was learnt through the review exercise.